No. 83-614

In the Supreme Court of the United States

OCTOBER TERM, 1983

SECURITIES INDUSTRY ASSOCIATION, PETITIONER

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE FEDERAL RESPONDENTS IN OPPOSITION

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QUESTION PRESENTED

Whether the court of appeals correctly upheld the decision of the Federal Reserve Board that neither the Bank Holding Company Act, 12 U.S.C. 1841 *et seq.*, nor provisions of the Glass-Steagall Act, 12 U.S.C. 24, 377, 378, prohibit a bank holding company from acquiring a nonbank subsidiary that is engaged in discount securities brokerage services.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-20a) is reported at 716 F.2d 92. The order of the Board of Governors of the Federal Reserve System (Pet. App. 21a-52a) is reported at 69 Fed. Res. Bull. 105. The Recommended Decision of the administrative law judge is not reported.

JURISDICTION

The judgment of the court of appeals was entered on July 15, 1983, and amended on September 20, 1983. The petition for a writ of certiorari was filed on October 13, 1983. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTES INVOLVED

1. Section 20 of the Banking Act of 1933 (the Glass-Steagall Act, 12 U.S.C. 377) and Section 4 of the Bank Holding Act of 1956 (12 U.S.C. 1843) are reproduced at Pet. App. 54a, 56a.

STATEMENT

1. On March 8, 1982, BankAmerica Corporation ("BAC"), a bank holding company within the meaning of the Bank Holding Company Act, 12 U.S.C. 1841(a)(1), applied to the Federal Reserve Board under Section 4(c)(8) of the Act, 12 U.S.C. 1843 (c)(8), for permission to acquire The Charles Schwab Corporation, and its wholly-owned discount brokerage subsidiary, Charles Schwab & Co., Inc. (Schwab).[1] Under BAC's proposal, Schwab would remain a separately incorporated broker, registered with the Securities and Exchange Commission. 15 U.S.C. 78o.

The Board published notice of BAC's application and requested comments. 47 Fed. Reg. 16104 (1982). In response, petitioner objected to the proposed acquisition and requested a formal hearing on BAC's application.[2] The request was granted by the

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[1] "Discount" brokers offer "bare-bones" transactional services—they arrange purchases and sales of securities solely as agents, upon the order and for the account of their customers, and do not offer investment research or advice. Discount brokers compete primarily on the basis of price, and are distinguished from their "full-line" competitors by lower commission rates (Pet. App. 3a).

[2] Comments on BAC's application were received from 99 sources. The Securities and Exchange Commission, the Comptroller of the Currency, and the Department of Justice all submitted comments favoring the proposal.

Board and extensive hearings were held in September 1982, before an administrative law judge (Pet. App. 22a).

On November 12, 1982, the administrative law judge issued a 164-page Recommended Decision recommending that the Board approve BankAmerica's application (C.A. App. A387-A557). In turn, the Board adopted the findings and conclusions of the administrative law judge in all material respects and approved BAC's application (Pet. App. 21a-52a). Applying the standards articulated in *National Courier Association* v. *Board of Governors*, 516 F.2d 1229, 1237 (D.C. Cir. 1975), to the extensive hearing record compiled with regard to the application, the Board concluded (Pet. App. 25a-27a, 50a-51a) that Schwab's discount securities brokerage services are "so closely related to banking * * * as to be a proper incident thereto" within the meaning of Section 4(c)(8) of the Bank Holding Company Act, 12 U.S.C. 1843(c)(8). This conclusion was based on the Board's findings that banks have traditionally and routinely purchased and sold stock and other securities as agent for their trust accounts, as well as for individual customers on an accommodation basis and, accordingly, banks are well-equipped to perform such services for the public (Pet. App. 25a-27a). In addition, as required by Section 4(c)(8), the Board found that BAC's proposed acquisition of Schwab could reasonably be expected to produce significant public benefits in the form of increased competition, convenience and efficiency in the provision of retail brokerage services, and would cause no significant adverse effects (Pet. App. 29a-42a). Finally, the Board concluded (Pet. App. 43a-47a) that since Schwab purchases and sells securities only in the sec-

ondary market as agent for retail customers and not for its own account, Schwab is not engaged in the "issue, flotation, underwriting, public sale, or distribution" of securities within the meaning of Section 20 of the Glass-Steagall Act, 12 U.S.C. 377, and therefore BAC's proposed acquisition did not contravene that provision.

3. The court of appeals affirmed the Board's order (Pet. App. 1a-20a). On the issue of the meaning of Section 20 of the Glass-Steagall Act, the court of appeals upheld the Board's conclusion that Schwab's brokerage services do not, as petitioner had contended, constitute the "public sale" of securities (Pet. App. 4a-13a). In so holding the court relied heavily upon the Board's longstanding construction of identical language in Section 32 of the Act, 12 U.S.C. 78, as excluding brokerage activities. The court likewise rejected petitioner's contention that Section 16 of the Glass-Steagall Act, 12 U.S.C. 24 Seventh, which limits a national bank to "purchasing and selling" securities "without recourse" upon the order and for the account of customers, and not for its own account, implicitly imposed restrictions on bank affiliates identical to those it expressly imposed on banks (Pet. App. 11a-13a).

The court also upheld as "clearly" supported by substantial evidence the Board's findings that banks "widely buy and sell securities for the accounts of their customers, and have become skilled in securities trading" (Pet. App. 16a). Accordingly, the court concluded that the Board properly held that Schwab's brokerage activities satisfy the "closely related" test of Section 4(c)(8) of the Bank Holding Company Act (Pet. App. 16a). The court rejected petitioner's contention that a nonbank activity must "facilitate" banking operations and be open to all banks in order

to satisfy the "closely related" test of Section 4(c)(8) (Pet. App. 17a-19a).

ARGUMENT

1. Petitioner argues (Pet. 10-14) that the Board and the court of appeals erred in holding that the "closely related" standard in Section 4(c)(8) of the Bank Holding Company Act permits a holding company to acquire a nonbank subsidiary that engages in activities that are "functionally so similar" to activities undertaken by banks, that banks are particularly well equipped to provide the proposed service. Petitioner asserts that, on the contrary, Congress intended to bar holding companies from acquiring any subsidiaries whose activities do not bear a "direct and significant" connection with banking. Pet. 12 (quoting, *Bank Holding Company Act Amendments: Hearings Before the House Comm. on Banking and Currency*, 91st Cong., 1st Sess. 199 (1969)).[3]

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[3] Petitioner's present contention that Section 4(c)(8) requires a "direct and significant" or "operational" connection between the proposed activities and banking (Pet. 12, 13) appears to be little, if anything, more than a verbal reformulation of the "facilitation" argument rejected by the court of appeals. In any event, the "direct and significant connection" reference was derived from an interpretation of Section 4(c)(8) prior to its amendment in 1970. Prior to 1970, Section 4(c)(6) authorized bank holding companies to engage in nonbank activities "of a financial, fiduciary, or insurance nature" determined by the Board to be "so closely related to *the business of* banking * * * as to make it unnecessary for the prohibitions of this section to apply in order to carry out the purposes of this Act." 70 Stat. 137. The Board interpreted this language as requiring a "direct and significant connection between the proposed activities * * * and the business of banking * * * as conducted by the bank holding company or its banking subsidiaries." *Bank Holding Company Act Amendments: Hearings Before the House Committee on Banking and Currency*, 91st Cong., 1st Sess. 196, 199 (1969) (testi-

Every court of appeals that has interpreted Section 4(c)(8), however, has approved the operational or functional similarity test first announced in *National Courier Ass'n* v. *Board of Governors, supra*, and subsequently embraced by the Board, *e.g. NCNB Corp.*, 64 Fed. Res. Bull. 506, 507 (1978). See Pet. App. 15a; *NCNB Corp.* v. *Board of Governors*, 599 F.2d 609, 613 (4th Cir. 1979); *Ass'n of Bank Travel Bureaus, Inc.* v. *Board of Governors*, 568 F.2d 549, 551 (7th Cir. 1978); *Alabama Ass'n of Insurance Agents* v. *Board of Governors*, 533 F.2d 224, 241 (5th Cir. 1976). Moreover, that standard is perfectly consistent with the reasoning of this Court in *Board of Governors* v. *Investment Company Institute*, 450 U.S. 46, 55 (1981), in upholding a regulation under Section 4(c)(8) allowing holding companies to acquire nonbanking subsidiaries that serve as investment advisers to closed-end investment companies. The Court held that such investment advice activities were closely related to banking because they were "not significantly different from the traditional fiduciary functions of banks." 450 U.S. at 55. It seems fairly clear that if this Court had concluded that there must

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mony of Hon. William McChesney Martin, Jr.); see also *One-Bank Holding Company Legislation of 1970: Hearings Before the Senate Comm. on Banking and Currency*, 91st Cong., 2d Sess. 139, 141 (1970) (testimony of Hon. Arthur F. Burns). At the Board's request, Congress deleted the words "the business of" from Section 4(c)(8) in 1970 to make it clear "that a nonbank subsidiary's activities should be related to banking * * * generally, rather than to the specific business carried on by the subsidiary banks of the particular holding company involved." See Letter from Hon. Arthur F. Burns to Hon. Wright Patman (Nov. 23, 1970), *reprinted in* 116 Cong. Rec. 41959 (1970) (remarks of Rep. Widnall); 116 Cong. Rec. 42433, 42434 (1970) (remarks of Sen. Bennett); H.R. Rep. 91-1747, 91st Cong., 2d Sess. 16 (1970). See *National Courier Association*, 516 F.2d at 1236 & n.14.

be a "direct and significant" or "operational" connection between the affiliate activities and banking in order for a holding company to acquire the nonbanking subsidiary, the regulation allowing the acquisition of investment advisers would not have been upheld. Accordingly, the court of appeals plainly applied the proper legal standard in deciding whether the Bank Holding Company Act prohibited this acquisition and the only issue is whether it applied that standard correctly.

In that regard, petitioner's only claim (Pet. 18-19) is that the approval of this acquisition by the court of appeals is inconsistent with a Fifth Circuit decision rejecting a portion of a Board regulation allowing the acquisition of nonbanking subsidiaries that engage in certain insurance brokerage activities. *Alabama Ass'n of Insurance Agents* v. *Board of Governors*, *supra*.[4] But the two cases are readily distinguishable on their facts. In rejecting the Board's finding that the sale of all types of insurance for a bank holding company and its subsidiaries is closely related to banking, the Fifth Circuit found that there was no evidence of any general practice by banks to broker insurance for themselves in any way that was " 'functionally' or 'integrally' related" to the insurance activities of the nonbank subsidiaries. 533 F.2d at 241. The court found that the only relationship between banks and insurance brokerage generally was

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[4] Petitioner asserts (Pet. 19) that the Fifth Circuit in *Alabama Ass'n of Insurance Agents* v. *Board of Governors*, *supra*, rejected the "functional or operational similarity" analysis employed below. But this claim is manifestly wrong. The Fifth Circuit expressly quoted the *National Courier Ass'n* standards with approval and merely concluded that portions of the Board's insurance regulation did not satisfy those standards. 533 F.2d at 241.

that banks, like any other business, need to be insured. *Ibid.* In this case, the Board and the court found on the basis of evidence that was both substantial and undisputed that the activity at issue here—purchasing and selling stocks and other securities as agent, upon the order and for the account of customers—is one that banks have performed for decades and in which national banks are expressly authorized to engage to at least some extent by Section 16 of the Glass-Steagall Act, 12 U.S.C. 24 Seventh (Pet. App. 15a-16a, 25a-28a). Cf. *Board of Governors* v. *Investment Company Institute*, 450 U.S. 46, 55 (1981) ("As executor, trustee, or managing agent of funds committed to its custody, a bank regularly buys and sells securities for its customers".).[5] Accordingly, the Fifth Circuit's conclusion that certain types of insurance activities were not " 'functionally' or 'integrally' related" to activities undertaken by banks is

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[5] The Board found that Schwab's securities brokerage activities differ from the traditional trading activities of banks only in that Schwab maintains seats on national securities exchanges and executes trades in listed securities on the floors of such exchanges, whereas banks traditionally have not held seats on an exchange and have employed intervening brokers for floor execution (Pet. App. 25a). The Board also found, however, that banks often execute their customers' securities trades in the over-the-counter market, and in doing so use the same techniques, employ personnel with the same training, and utilize the same equipment that Schwab does in executing similar transactions (*id.* at 25a-26a). In addition, the Board found that in selecting and directing floor brokers to execute trades in listed securities, banks often instruct the executing broker as to the best method of execution, leaving to the broker only the ministerial task of effecting the transaction in accordance with the bank's instructions (*ibid.*). The court below concluded that these findings were "clearly" supported by substantial evidence (Pet. App. 16a).

in no way inconsistent with the holding that providing discount brokerage services is "closely related to banking." There is therefore no reason for this Court to review the court of appeals' decision that BAC's application to acquire Schwab is permissible under Section 4(c)(8) of the Bank Holding Company Act.

2. Petitioner argues (Pet. 14-18) that the Board's approval of BAC's application to acquire Schwab is inconsistent with Section 20 of the Glass-Steagall Act, 12 U.S.C. 377, which provides:

> [N]o member bank [of the Federal Reserve System] shall be affiliated * * * with any corporation, association, business trust, or other similar organization engaged principally in the issue, flotation, underwriting, public sale, or distribution at wholesale or retail or through syndicate participation of stocks, bonds, debentures, notes, or other securities * * *.

Specifically, petitioner asserts that Schwab is engaged principally in the "public sale" of securities. This contention is without merit.

Petitioner's claim is not predicated on anything in Section 20, itself, but rather on its view of how Section 20 should be interpreted in light of Section 16 of the Glass-Steagall Act, 12 U.S.C. 24, which regulates the activities of banks as opposed to bank holding companies. Petitioner's desire to ignore the language of Section 20 is readily understandable. Section 20 does not by its terms refer to "brokerage," and the execution of orders to buy and sell securities solely as agent for customers does not fall within the commonly accepted meaning of "public sale," which in context implies the widespread marketing of new securities by dealers trading as principals for their own profit. See L. Loss, *Securities Regulation* 159-172 (2d ed. 1961). Moreover, since 1936 the Board

has consistently interpreted identical language in Section 32 of the Glass-Steagall Act, 12 U.S.C. 78 (also applicable to bank affiliates), as excluding public securities brokerage.[6] This Court accepted and employed the Board's construction of Section 32 in *Board of Governors* v. *Agnew*, 329 U.S. 441, 445-446 & n.3 (1947)[7] and has consistently recognized the distinction drawn by the Glass-Steagall Act between underwriting and brokerage activities. *Board of Governors* v. *Investment Company Institute*, 450 U.S. at 63, 66 n.37; *Investment Company Institute* v. *Camp*, 401 U.S. 617, 638 (1972).

Nor is there any basis for modifying the plain and settled meaning of Section 20 because of the very different language and purpose of Section 16. In *Board of Governors* v. *Investment Company Institute*, 450 U.S. at 58, this Court recognized that Section 16 "appl[ies] only to banks and not to bank holding companies." 450 U.S. at 58, n.24.[8] There is

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[6] See Regulation R, 22 Fed. Res. Bull. 51 (1936), codified at 12 C.F.R. 218.1 n.1.

[7] In *Agnew*, this Court upheld the Board's determination that a securities firm was "primarily" engaged in the activities described in Section 32 of the Act even though less than half of the firm's revenues were derived from "underwriting" activities. As the court of appeals here noted (Pet. App. 7a), this Court would have had no occasion to interpret the term "primarily" had it considered the firm's brokerage activities to be within the scope of the statutory language.

[8] In arguing that those sections should be interpreted as imposing identical restrictions on banks and bank affiliates, petitioner ignores the differences in the language of Sections 16 and 20. Section 16 of the Act, applicable to national *banks*, provides in pertinent part, 12 U.S.C. 24 Seventh:

> The business of dealing in securities and stock by the [national bank] association shall be limited to purchasing

simply no basis for incorporating Section 16's restrictions on national banks into Section 20, where Congress obviously intended "that a bank affiliate may engage in activities that would be impermissible for the bank itself." 450 U.S. at 64. The decision below rejecting petitioner's contention is correct and conflicts with no decision of any other court; it therefore does not warrant further review.[9]

> and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and the association shall not underwrite any issue of securities or stock * * *.

Nowhere does Section 16 mention public sales. Indeed, by its terms, the statute authorizes banks to purchase and sell "securities and stock" upon the order and for the account of customers.

[9] Petitioner suggests (Pet. 6-10) that this decision warrants review because it is part of a pattern of efforts by other agencies of the federal government to alter their regulatory practices relating to the banking industry. But, as petitioner admits (Pet. 10), the decision here does not involve the same legal issues as those regulatory decisions. If the government's regulatory efforts in other spheres are not supported by statutory authority, they will be subject to judicial review, if necessary, in this Court.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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DECEMBER 1983

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